UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

In re **PAIGE SCARLETT O'DOWD,** Debtor.	Case No. **04-62325-7**

MEMORANDUM OF DECISION

At Butte in said District this 11th day of March, 2005.

In this Chapter 7 bankruptcy, after due notice, a hearing was held March 8, 2005, at Butte on Debtor's Motion to Amend Schedules filed February 6, 2005. Also pending in this case and set for hearing on April 5, 2005, is the Motion to Strike Amended Schedule B filed by Stanley Steemer International, Inc. ("Stanley") on February 16, 2005. Debtor was represented at the hearing by her counsel of record, James J. Screnar, of Bozeman, Montana, while Stanley was represented by attorney Joel E. Guthals, of Billings, Montana. The Chapter 7 Trustee, William M Kebe, Jr., of Butte, Montana, was also present at the hearing and testified. Debtor was listed as a witness by both Debtor's counsel and Stanley. However, Debtor failed to appear at the hearing. Stanley's Exhibits A through H were admitted into evidence without objection. At the conclusion of the hearing, the Court denied Debtor's Motion to Amend Schedules for bad faith. For the reasons discussed herein, the Court also finds it appropriate to grant Stanley's Motion to Strike Amended Schedule B and vacate the hearing scheduled for April 5, 2005. This memorandum contains the Court's findings of fact and conclusions of law.

BACKGROUND

On June 3, 2002, Debtor and her spouse entered into a Franchise Agreement with Stanley wherein Debtor and her spouse obtained an exclusive license to operate a Stanley Steemer carpet and upholstery cleaning business in the Butte-Bozeman and Billings market areas. Debtor and her spouse assigned their Stanley Franchise Agreement to a corporation, On The Fly, Inc., owned by Debtor and her spouse, but nevertheless agreed to remain personally liable for all obligations due Stanley under the terms of the Franchise Agreement. In January of 2004, Stanley terminated its Franchise Agreement with Debtor, her spouse and On The Fly, Inc. due to alleged material breaches of the Franchise Agreement, and filed a complaint against Debtor, her spouse and On The Fly, Inc. in the United States District Court for the District of Montana, Butte Division ("District Court"). *See Stanley Steemer International, Inc. vs. John O'Dowd, Scarlett Paige O'Dowd, and On The Fly, Inc.*, Cause No. CV-04-8-BU-RFC.

In response to the District Court litigation, Debtor's spouse, John Steven O'Dowd ("John"), filed for protection under Chapter 13 of the Bankruptcy Code on February 12, 2004.[1] The District Court litigation was stayed after John filed his Chapter 13 bankruptcy petition, but the District Court subsequently lifted the stay with respect to Debtor and On The Fly, Inc. on March 15, 2004. The District Court proceeded to issue a preliminary injunction against Debtor

[1] The aforementioned Chapter 13 case was dismissed by the Court on August 17, 2004, for John's "failure to file all required tax returns as ordered by this Court by written Order entered July 13, 2004." Following the dismissal of John's first bankruptcy, Stanley sought to proceed with the District Court litigation against John and On The Fly, Inc. According to Stanley, the above efforts to proceed with the District Court litigation against John and On The Fly, Inc. prompted John to file his second bankruptcy proceeding on September 14, 2004. John's second bankruptcy petition was dismissed on October 4, 2004, after he failed to timely file his bankruptcy schedules.

and On The Fly, Inc. on April 15, 2004.

Thereafter, Debtor filed a voluntary Chapter 7 bankruptcy petition on July 28, 2004. Debtor, like her spouse, filed a notice of the bankruptcy in District Court asserting that the pending District Court litigation should be stayed. Debtor filed Schedules and a Statement of Financial Affairs on August 12, 2004. Debtor lists Stanley as a creditor on Schedule F. Debtor, however, does not list any suits or administrative "proceedings to which the debtor is or was a party within one year immediately proceeding the filing of this bankruptcy case." Debtor also failed to list her counterclaim against Stanley as an asset of the bankruptcy estate on Schedule B. Moreover, Debtor failed to disclose her counterclaim against Stanley at the § 341 meeting of creditors held in Butte on September 22, 2004. On November 4, 2004, Stanley filed a Motion in the instant case seeking authority to proceed with the pending District Court litigation. Stanley's unopposed Motion to Modify Stay, which was granted by this Court on November 18, 2004, recites that Debtor owes Stanley $134,124.24 stemming from a prepetition claim.

Debtor received a Chapter 7 discharge of her debts on November 23, 2004. Nothing else transpired in this case with respect to Stanley until February 6, 2005, when Debtor sought to include her pending counterclaim against Stanley as an asset on Schedule B. Stanley opposes Debtor's attempt to amend her Schedule B asserting that Debtor is amending her Schedule B in bad faith. Stanley asserts that Debtor is seeking to amend Schedule B to create a defense to Stanley's motion to dismiss Debtor's counterclaim in District Court.

APPLICABLE LAW

Rule 1009(a), F.R.B.P., provides that a debtor may amend his or her schedules "as a matter of course at any time before the case is closed." Consistent with the liberal amendment

allowed by Rule 1009, the Ninth Circuit Bankruptcy Appellate Panel has held that a debtor may amend lists or schedules without court permission at an time during the pendency of a case. *In re Andermahr*, 30 B.R. 532, 533 (9th Cir. BAP 1988). Notwithstanding the foregoing general rule of liberal amendment, a bankruptcy court has the discretion to deny the amendment of a debtor's schedules if the amendment is proposed in bad faith or would prejudice creditors. *In re Michael*, 17 Mont. B.R. 192, 198, 163 F.3d 526, 529 (9th Cir. 1998) (citing *In re Doan*, 672 F.2d 831, 833 (11th Cir. 1982) (per curiam)). *See also*, *In re Kaelin*, 308 F.3d 885, 889 (8th Cir. 2002) ("[T]he policy of freely allowing amendment, while the case is still open, is not an absolute and can be tempered by the actions of the debtor or the consequences to the creditors. The two recognized exceptions to this rule are bad faith on the part of the debtor and prejudice to the creditors. *See In re Doan*, 672 F.2d at 833 ('[A] court might deny leave to amend on a showing of a debtor's bad faith or of prejudice to creditors.'); *In re Osborn*, 24 F.3d 1199, 1206 (10th Cir.1994) (same); *Lucius v. McLemore*, 741 F.2d 125, 127 (6th Cir.1984) (noting that courts may deny an amendment where the debtor has acted in bad faith or where property has been concealed)."). A mere allegation of bad faith is insufficient; bad faith must be established by clear and convincing evidence. *Michael*, 163 F.3d at 529; *In re Magallanes*, 96 B.R. 253, 256 (9th Cir. BAP 1988); *But see Arnold v. Gill (In re Arnold)*, 252 B.R. 778, 785-86 (9th Cir. BAP 2000) (questions, but does not answer, the appropriate burden of proof: preponderance of the evidence or clear and convincing evidence, after the decision in *Grogan v. Garner,* 498 U.S. 279, 111 S.Ct 654 (1991)). This Court, for purposes of this decision, concludes that the evidence satisfies both burdens of proof, and leaves to another day any determination as to which burden is appropriate after *Grogan*. The usual ground for finding bad faith is a debtor's attempt to hide assets. *Arnold*,

252 B.R. at 785-86. As explained by the BAP in *Arnold*:

> The rationale for this judge-made "bad faith" exception to Rule 1009(a)'s liberal policy of amendments is:
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> > [A]lthough amendments before discharge are liberally allowed ... [the debtors'] omissions from the initial list suggest that they meant to hide assets if they could get away with it....The operation of the bankruptcy system depends on honest reporting. If debtors could omit assets at will, with the only penalty that they had to file an amended claim once caught, cheating would be altogether too attractive. *Yonikus, supra*, 996 F.2d at 872, quoting *Payne v. Wood*, 775 F.2d 202, 205 (7th Cir.1985), *cert. denied*, 475 U.S. 1085, 106 S.Ct. 1466, 89 L.Ed.2d 722 (1986).

A court faced with the question of whether a debtor has filed schedules in bad faith should examine a "totality of the circumstances." *Kaelin*, 308 F.3d at 889.

DISCUSSION

In the instant case, the Court finds that the totality of the circumstances establish by clear and convincing evidence that Debtor acted in bad faith in failing to disclose her counterclaim against Stanley and in attempting to amend her Schedule B to include the counterclaim once the existence of the asset came to light. First, Debtor failed to disclose not only her counterclaim against Stanley on her Schedule B, but Debtor also failed to disclose the entire lawsuit with Stanley in her Statement of Financial Affairs. In particular, question 4 of the Statement of Financial Affairs directs Debtor to: "List all suits and administrative proceedings to which the debtor is or was a party within **one year** immediately preceding the filing of this bankruptcy case." Debtor answered "none" to the above question, even though Stanley had commenced its action against Debtor, John and On The Fly, Inc. only 7 months prior to Debtor's petition date. Debtor failed to list not only the District Court litigation itself, but also the related counterclaim.

When questioned under oath by the Trustee at the § 341 meeting of creditors, Debtor testified as follows:

THE TRUSTEE: . . . Prior to filing bankruptcy, did you have a chance to review your bankruptcy schedules?

MRS. O'DOWD: Yes.

THE TRUSTEE: And other than what – what we've already determined is wrong here; they're accurate and correct --

MRS. O'DOWD: – Yes.

THE TRUSTEE: – otherwise?

MRS. O'DOWD: Yes.

THE TRUSTEE: Properly lists all your assets?

MRS. O'DOWD: Yes.

Exhibit B. The above statements made by Debtor under oath combined with the fact that Debtor promptly filed notice of her bankruptcy case with District Court after she sought relief under the Bankruptcy Code establishes that Debtor knew of both the pending litigation and the counterclaim, despite any allegations to the contrary that Debtor may have made had she appeared at the March 8, 2005, hearing.

Also, on September 22, 2004, Debtor signed a Declaration under penalty of perjury that she had read her schedules and statement of financial affairs and that they were true and correct. Exhibit G. Additionally, counsel for Stanley appeared at Debtor's § 341 meeting of creditors, and the following exchange took place between Debtor and Stanley's counsel:

MR. GEDDES: Now, the Stanley Steemer franchise agreement was terminated for non-

payment of your franchise fees? Is that right?

MRS. O'DOWD: Right.

MR. GEDDES: OK. And you've listed the debt as a hundred and thirty-five thousand dollars ($135,000.00), payable to Stanley Steemer in your schedule; is that the amount that you believe you owe Stanley Steemer?

MRS. O'DOWD: Around – about there, yes.

MR. GEDDES: And you don't dispute that you owe that amount to Stanley Steemer?

MRS. O'DOWD: No.

MR. GEDDES: Now, you're aware that Stanley Steemer has sued your husband and yourself, and On the Fly, Inc., in federal court - -

MRS. O'DOWD: – Absolutely.

Upon questioning by Stanley's counsel, Debtor acknowledged the existence of the District Court litigation and further acknowledged that Debtor and her spouse owed Stanley roughly $135,000.00. However, even after the above exchange, Debtor still failed to disclose the pending counterclaim. In fact, Debtor did nothing to disclose the counterclaim until Stanley moved to dismiss Debtor's counterclaim in District Court arguing that Debtor was judicially estopped from pursuing a claim that was not disclosed in her bankruptcy.

Debtor's amendment and its timing are meretricious and suspicious. Stanley's motion to dismiss Debtor's counterclaim was filed on January 27, 2005, and Debtor promptly sought to amend her Schedule B on February 6, 2005, to include the counterclaim against Stanley.

Finally, the fact that Debtor failed to appear at the March 8, 2005, hearing does not bode well with the Court. Debtor's counsel indicated at the hearing that Debtor was aware of the

hearing. Debtor's counsel was also of the belief that Debtor would be in attendance at the hearing. Debtor did not appear at the hearing and Debtor failed to notify her attorney prior to the hearing that she would not be able to attend the hearing.

Given the foregoing, the Court finds that Debtor's failure to list her counterclaim against Stanley was an obvious attempt to conceal assets. It was not until Debtor discovered that the viability of her counterclaim was in jeopardy that Debtor sought to apprise her bankruptcy counsel of the pending counterclaim and add such asset to her bankruptcy schedule.

The protections afforded by the Bankruptcy Code are for the honest but unfortunate Debtor. The Debtor in this case has not been honest with the Court, the Chapter 7 Trustee or her creditors. Accordingly, the Motion to Amend Schedule B is denied. Similarly, Debtor's attempt to sidestep Stanley's objection by simply filing the amended Schedule B will not be tolerated by the Court. Thus, Stanley's Motion to Strike is granted and Debtor's amended Schedule B is stricken from the record.

The Court would note that after the Court made its ruling in Court on Stanley's objection to Debtor's Motion to Amend Schedule B, counsel for Debtor argued that the Court's ruling was not appropriate because the Court had not found any prejudice to Stanley as a result of Debtor's actions. The requirement of bad faith or prejudice to creditors is in the disjunctive and not the conjunctive. The Court need not find that Debtor's failure to timely amend her schedules prejudiced either Stanley or other creditors.[2] In accordance with the foregoing,

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[2] "Prejudice to creditors can be shown in several ways. First, prejudice may arise if the creditors suffer actual economic loss due to a debtor's delay in claiming his exemption. *In re Arnold*, 252 B.R. at 787. Prejudice to creditors may also be shown by proving the amendment would harm the litigation posture of the creditors. If the parties would have taken different actions or asserted different positions had the exemption been claimed earlier, and the interests of those parties are detrimentally affected by the timing of

IT IS ORDERED that a separate Order will be issued consistent with the following:

IT IS ORDERED that Debtor's Motion to Amend Schedule B is DENIED.

IT IS FURTHER ORDERED that Stanley Steemer International, Inc.'s Motion to Strike Amended Schedule B is GRANTED; Debtor's Amended Schedule B filed February 11, 2005, is stricken from the record; and the hearing scheduled for April 5, 2005, on Stanley Steemer International, Inc.'s Motion to Strike Amended Schedule B is vacated.

BY THE COURT

HON. RALPH B. KIRSCHER
U.S. Bankruptcy Judge
United States Bankruptcy Court
District of Montana

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the amendment, then the prejudice is sufficient to deny amendment. Moreover, an amendment is prejudicial if it impairs a trustee in the diligent administration of the estate. *In re Talmo*, 185 B.R. 637, 645 (Bankr.S.D.Fla.1995)." *Kaelin*, 308 F.3d at 890.